DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 00-0408; 00-0409
Indiana Gross Income Tax
For the Tax Years 1995, 1996, and 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Applicability of the State Gross Income Tax to Taxpayers' Procurement and Transfer of Steel Products.

Authority: IC 6-2.1-1-2; IC 6-2.1-1-2(a); IC 6-2.1-2-2; 45 IAC 1.1-3-3(d)(1); 45 IAC 1.1-3-3(d)(2); 45 IAC 1.1-3-3(d)(7).

Taxpayers enter into various transactions for the procurement of steel on behalf of third-party customers. The exact nature of the transactions being at issue, taxpayers protest the imposition of the state's gross income tax on those transactions. Audit characterized the transactions as the purchase and sale of steel. Taxpayers argue that they are merely performing services indirectly related to the procurement of the steel. Taxpayers argue that because they do not take title to the steel, do not take possession of the steel, have no responsibility for loss or damage to the steel, taxpayers should not be subject to the gross income tax.

STATEMENT OF FACTS

Taxpayers are sister corporations involved in the procurement of commodities. Taxpayer One is incorporated in New York and maintains branch offices in various parts of the country. It does not maintain a branch office in Indiana. When a third-party customer decides to purchase a commodity, third-party customer deals directly with Taxpayer One for the procurement of that commodity.

Taxpayer Two is incorporated in Delaware but maintains its only office in New York City. Taxpayer Two specializes in the procurement of steel and steel-related products. Taxpayer Two, in effect, acts as the steel procurement arm for Taxpayer One.

When third-party customer wishes to obtain steel, it makes contact with Taxpayer One. Taxpayer One transfers the "order" to Taxpayer Two which, in turn, deals directly with the steel mill. Both Taxpayer's charge a fee for their services. Ultimately, the invoice for the steel purchase – together with both Taxpayers' fees – is sent to the third-party customer by Taxpayer One.

The audit determined that Taxpayers were in the business of buying and selling steel. Audit imposed the gross income tax on the amounts recorded as "sales" from Taxpayer Two to Taxpayer One and from Taxpayer One to Indiana customer. Taxpayers disagree, characterizing themselves as merely service providers facilitating the purchase of steel on behalf of third-party customers.

DISCUSSION

I. Applicability of the State Gross Income Tax to Taxpayers' Procurement and Transfer of Steel Products.

Taxpayers enter into various transactions for the procurement of steel. Two types of transactions are at issue. The first type of transaction may be characterized as follows.

Transaction One:

Indiana third-party customer, interested in acquiring steel, approaches Taxpayer One which accepts customer's order. For the purpose of this illustration, customer wishes to purchase $100 worth of steel. For purposes of this illustration, the fees charged by Taxpayers are representations only and are not intended to illustrate the actual fee structure of either Taxpayer.

Taxpayer One turns the order over to its sister corporation, Taxpayer Two, which deals directly with Indiana steel mill. Taxpayer Two places an order for $100 worth of steel. Taxpayer Two, having performed a service on behalf of third-party customer, adds a percentage fee to the cost of the steel. At this point, the steel will cost third-party customer $104.

Taxpayer Two, having completed initial procurement of the steel, invoices Taxpayer One for $104. Subsequently, Taxpayer One, having performed a service on behalf of third-party customer adds its own service fee. The steel will now cost third-party customer $105. The $105 represents the initial cost of the steel, Taxpayer Two's fee, and Taxpayer One's fee. Taxpayer One invoices third-party customer $105.

Third-party customer now deals directly with Indiana steel mill for the purpose of transporting and acquiring possession of the steel. Neither Taxpayer provides for the transport of the steel.

Both taxpayers maintain that they are merely service providers. Both taxpayers maintain that they do not take title to the steel, do not take possession of the steel, and do not bear the risk of loss for the steel. Taxpayers see themselves as service providers outside the actual "purchase" and "sale" of the steel products.

Audit disagrees, characterizing these various transactions as the buying and selling of steel and that the income realized by these transactions is subject to the state's gross income tax.

Transaction Two:

Taxpayers enter into a second type of transaction which is also the subject of this protest. Taxpayer Two characterizes this second transaction as its "Single Billing Business."

Out-of-state customer decides to purchase coated steel. Out-of-state customer approaches Taxpayer One and places an order to acquire a specified amount of coated steel.

Taxpayer One turns the order over to Taxpayer Two. Taxpayer Two, operating from its Chicago office, deals directly with out-of-state steel mill and places an order for uncoated steel.

The uncoated steel is transported to a coating plant located in Indiana. It is not disputed that, at this point, Taxpayer Two has acquired the uncoated steel and maintains that steel in its own inventory.

Once the steel has been coated, out-of-state customer arranges to take possession of the steel at the coating plant site. It is not disputed that a "sale" of the coated steel from Taxpayer Two to out-of-state customer has occurred and that this transaction is subject to the state's gross income tax.

Taxpayer Two records a "purchase" of steel from the mill and a "sale" to Taxpayer One. Taxpayer One records a "purchase" from taxpayer Two and a "sale" to out-of-state customer. Taxpayer Two invoices Taxpayer One and Taxpayer One invoices out-of-state customer. Because out-of-state customer receives one invoice – which includes the original cost of the raw steel, cost of the steel coating, and both taxpayers' fees – Taxpayer Two calls this its "Single Billing Business."

What is in dispute is whether Taxpayer One has entered into a transaction for which the receipts are subject to the gross income tax.

DISCUSSION

I. Applicability of the State Gross Income Tax to Taxpayers' Transfer of Steel Products.

With respect to non-resident taxpayers, the Indiana gross income tax is imposed under the authority of IC 6-2.1-2-2(a) which states that "[a]n income tax, known as the gross income tax, is imposed upon the receipt of . . . the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana."

The definition of "gross income" is provided for in IC 6-2.1-1-2. As relevant to taxpayers' particular circumstances, that statute states "'gross income' means all the gross receipts a taxpayer receives . . . from the sale, transfer, or exchange of property, real or personal, tangible or intangible." IC 6-2.1-1-2(a).

Taxpayer argues that it is not "selling" the steel products. Taxpayer takes the position that it is acting as a facilitator for the transfer of the steel products between the steel mill and the ultimate consumer of those products. According to taxpayer, because their various fees – earned from facilitating the transfer of the steel from the steel mill to the third-party customer – are earned from activities occurring entirely out-of-state, those fees are not subject to the state's gross income tax. According to taxpayer, because the cost of the steel is a liability incurred by third-party customer in favor of the steel mill, that cost is not subject to the state's gross income tax.

Taxpayers' own records, the form and nature of the steel transactions, and the simple realities of those transactions, contradict taxpayers' assertions. Taxpayers books these transactions as "sales" and "purchases" in their own records. Taxpayers record their gross sales each year and calculate a gross profit based on those sales. Taxpayers record an ending inventory in their accounts each year. Each sale is invoiced and the sale is recorded as a gross sale in taxpayers' accounts. Taxpayers' various fees and the price of the steel is included as part of the taxpayers' "cost of goods sold" recorded on taxpayers' Federal Income Tax returns. The invoices issued between the parties are indistinguishable from a simple combined invoice for services, tangible personal property, and related fees.

Taxpayers argue that they do not take physical possession of the steel, do not arrange for the conveyance of the steel, and do not bear the risk of loss or damage for the steel. However such qualifications and distinctions are insufficient to avoid the conclusion that taxpayers are purchasing steel, "marking up" the cost of that steel, and transferring ownership of the steel to third-party customers.

Under the circumstances as described in "Transaction One," Taxpayer Two invoiced Taxpayer One after Taxpayer One initially acquired the steel. The gross receipts from those transactions are subject to the gross income tax under 45 IAC 1.1-3-3(d)(2). That regulation states that:

> "[g]ross income derived from the sale of tangible personal property in interstate commerce is subject to the gross income tax if the sale is completed in Indiana. The following examples are situations where a sale is completed in Indiana prior to or after shipment in interstate commerce . . . . a sale to a non resident where the goods become the property of the buyer but are kept within Indiana by the seller until they are resold by the buyer . . . ."

Similarly, under the circumstances as described in “Transaction One,” Taxpayer One invoiced Indiana third-party customer for the steel that Indiana third-party customer had originally ordered. The gross receipts from those transactions are subject to the gross income tax because, under 45 IAC 1.1-3-3(d)(7), the sale was made to “an Indiana buyer by a nonresident seller [and the sale] was channeled through; or . . . was otherwise connected with; an Indiana business situs established by the seller.”

Under the circumstances as described in “Transaction Two,” Taxpayer Two records a purchase of steel from the mill and conducts a sale to Taxpayer One. The gross receipts from those transactions are subject to the gross income tax under the provisions set out in 45 IAC 1.1-3-3(d)(2).

Under the circumstances as described in “Transaction Two,” Taxpayer One records a purchase from Taxpayer Two and invoices out-of-state third-party customer. The gross receipts from those transactions are subject to the gross income tax under the provisions of 45 IAC 1.1-3-3(d)(1) which states that the gross income tax is imposed on “[a] sale to a nonresident where the goods are picked up in Indiana by the buyer via its own carrier.”

Conceivably, taxpayers could structure their business transactions in such a way that taxpayers would be function simply as disinterested brokers. In such a theoretical setting, taxpayers would match interested buyers with willing sellers and charge the participants a fee for brokering the resulting transaction. However, for the transactions here at issue, taxpayers’ business is indistinguishable from the straightforward purchase and sale of steel commodities.

FINDING

Taxpayers’ protest is respectfully denied.

DK/MR – 011309